



## CONGRESSIONAL BUDGET OFFICE PRIVATE-SECTOR MANDATE STATEMENT

November 10, 1999

### **H.R. 3081** **Wage and Employment Growth Act of 1999**

*As ordered reported by the House Committee on Ways and Means on November 9, 1999*

#### **SUMMARY**

H.R. 3081 would increase the federal minimum wage in three steps from \$5.15 to \$6.15 by April 2002. It would reduce taxes for certain small businesses, change the tax treatment of certain pension plans, and reduce estate and gift taxes.

#### **PRIVATE-SECTOR MANDATES CONTAINED IN BILL**

Section 101 of H.R. 3081 would impose a mandate on private-sector employers covered by the Fair Labor Standards Act (FLSA) because it would require them to pay a higher minimum wage rate than they are required to pay under current law. In addition, the Joint Committee on Taxation has determined that two revenue provisions of the bill contain private-sector mandates. One would impose a 10 percent vote or value test for Real Estate Investment Trusts (REITs). The other would change the treatment of income and services provided by taxable REIT subsidiaries.

#### **ESTIMATED DIRECT COST TO THE PRIVATE SECTOR**

CBO's estimate of the direct cost of the private-sector mandates in Section 101 of H.R. 3081 is displayed in the following table, along with the Joint Committee on Taxation's estimate of the private-sector mandates imposed on REITs by the revenue provisions. The cost of the mandates in the bill would exceed the threshold specified in the Unfunded Mandates Reform Act of 1995 (\$100 million in 1996, adjusted annually for inflation) in each of the first five years following enactment.

Provision	By Fiscal Year in Billions of Dollars				
	2000	2001	2002	2003	2004
Increase the federal minimum wage	0.5	1.6	3.4	4.1	3.7
Real Estate Investment Trust	---	0.06	0.17	0.06	0.03

## **BASIS OF ESTIMATE**

H.R. 3081 would increase the federal minimum wage in three annual steps, beginning on April 1, 2000. The provision of the FLSA permitting employers to pay teenagers \$4.25 per hour during the first 90 consecutive days of employment would not change. (The estimates in the table are based on the assumption that the federal minimum wage would rise to \$6.15 per hour on April 1, 2002, and remain at that wage rate. The language in the bill, as reported, is unclear as to what the minimum wage rate would be on April 1, 2003, and thereafter. Staff of the sponsor indicated that the bill will be clarified to assure that the federal minimum wage would not revert to \$5.15 per hour on April 1, 2003.)

To estimate the direct cost to private employers of raising the minimum wage, CBO used information on the number of workers whose wages would be affected in April 2000 and subsequent months, the wage rates those workers would receive in the absence of the bill, and the number of hours for which they would be compensated.

The estimate was made in two steps, which are described in more detail below. First, CBO used data from the Current Population Survey (CPS) to estimate how much it would have cost employers to comply with the mandate had they been required to do so in early 1999. Second, this estimate was used to project the costs to employers beginning in April 2000, taking into account the expected decline in the number of workers in the relevant wage range.

### **Estimates from the Current Population Survey**

Data on hourly wage rates contained in the March 1999 CPS are the basis for CBO's estimate of the number of private-sector workers in that month who were paid a wage rate in the relevant range. At that time, about 1.3 million workers in the private sector reported being paid exactly \$5.15 per hour. About 700,000 workers reported being paid \$5.00 per hour; CBO assumes that these workers were also covered by the \$5.15 minimum wage and misreported their wage rate. An additional 7.6 million workers were paid between \$5.16 and

\$6.14 per hour. Roughly one-third of the workers in the relevant wage range were teenagers. Based on information from the Bureau of Labor Statistics, CBO assumes that about 30 percent of those teenagers were in their first 90 days of employment with their current employer and therefore not covered by the increase in the minimum wage in H.R. 3081.<sup>1</sup>

CBO estimates that if the private-sector workers who had been paid between \$5.15 and \$5.47 per hour in March 1999 had been paid \$5.48 instead (with no change in the number of hours worked), their employers would have paid them approximately \$80 million in additional wages in that month. If the workers who had been paid between \$5.15 and \$5.80 per hour had been paid \$5.81, their employers would have incurred an additional wage bill of about \$240 million in that month. If the workers who had been paid between \$5.15 and \$6.14 had been paid \$6.15, their employers would have incurred an additional wage bill of about \$500 million in that month. Moreover, employers would have been required to pay their share of legally mandated costs that are tied to a worker's wages; these payments are included in CBO's estimate of the total direct cost of the mandate.

### **Applying the Estimates from the CPS to the Projection Period**

The monthly cost to employers of the proposed increases in the minimum wage would be smaller in the future than now because the number of workers in the affected range will decline, as it did after previous increases in the minimum wage rate. For example, between 1992 and 1995, the number of workers earning \$4.25 per hour (the minimum wage rate which became effective in April 1991) fell by about 30 percent. Between September 1997 and March 1999, the number of workers paid \$5.15 per hour (the minimum wage rate established in September 1997) fell by an even greater amount as market forces and increases in state minimum wage rates raised the level of wages paid. CBO assumes that the direct cost of the mandate would steadily decrease at a rate of about 10 percent per year throughout the projection period.

Estimates for each fiscal year were made by aggregating the monthly costs. The estimate for fiscal year 2000 is the smallest because that period would include an increased minimum wage for only six months. The estimate of the direct cost to the private sector is highest for 2003, when all twelve months would be at \$6.15 per hour.

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1. This estimate is derived from information on job tenure, by age, provided by the Bureau of Labor Statistics. That information is based on supplemental questions included in the February 1998 Current Population Survey.

## Limitations

Estimates of the direct cost of this mandate are uncertain for at least two reasons. First, the main source of data—the March 1999 CPS—is subject to sampling error and other problems when used for this purpose. For example, there is uncertainty about the actual wage rate of workers who said that they were paid \$5.00 per hour. CBO assumed that the workers who reported being paid this rate after the minimum wage had risen to \$5.15 were actually paid \$5.15 because there is no evidence that compliance with the Fair Labor Standards Act fell. In addition, the wage rates of certain other low-wage workers (some who reported being paid below \$5.00 per hour and some who were not paid on an hourly basis) would also be affected by an increase in the statutory minimum, but the CPS does not provide reliable estimates of the number of such workers nor the increase in mandate cost that would be attributable to them.<sup>2</sup>

A second source of uncertainty in this estimate is the fact that there is no solid basis for projecting the future number of workers who will have wage rates in the relevant range, their precise wage rates, nor the number of hours they will work under current law. The annual decline estimated from earlier periods could turn out to be too rapid or too slow.

## INDIRECT EFFECTS OF AN INCREASE IN THE MINIMUM WAGE

An increase in the minimum wage rate from \$5.15 to \$6.15 would require employers to raise the wage rates paid to the lowest-paid workers covered by the FLSA by 19 percent and would require employers to raise the wages of workers in the range between the old and the new statutory rates by smaller amounts. As under current law, employers could still pay teenage workers \$4.25 per hour during their first 90 calendar days of employment.

Economists have devoted considerable energy to the task of estimating how employers would respond to such a mandate. Although most economists would agree that an increase in the minimum wage rate would cause firms to employ fewer low-wage workers (or employ them for fewer hours), there is considerable disagreement about the magnitude of the reduction. The main reason for this disagreement is that it has proven difficult to distinguish the effects on employment of past changes in the minimum wage from other changes in the labor market. Moreover, the estimates from such analyses are difficult to apply to future changes because labor market conditions will be different.

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2. In March 1999, 1.1 million workers reported being paid an hourly wage rate of less than \$5.00. Some workers, such as employees in retail firms whose gross volume of sales is less than \$500,000 are not covered by the minimum wage, while others, such as certain tipped workers, are covered but can be paid a lower wage rate.

Based on CBO's review of a number of relevant studies, a plausible range of estimates of the potential job losses is that a 10 percent increase in the minimum wage would result in a 0.5 percent to 2 percent reduction in the employment level of teenagers and a smaller percentage reduction for young adults (ages 20 to 24).<sup>3</sup> These estimates imply employment losses for an increase in the minimum wage of the amount provided in H.R. 3081 of roughly 100,000 to 500,000 jobs.

The low end of this range might be more realistic because the number of minimum-wage workers is smaller than it was during most of the time periods when the employment effects were estimated in the literature. Although the current minimum wage rate of \$5.15 has been in place for only about two years (since September 1997), relatively few workers are paid that rate. In March 1999, only about 2 million workers were paid the federal minimum wage. During much of the past two decades, when many of the studies were undertaken, between 2 million and 4 million workers were paid the minimum wage.

Moreover, the 1996 increase in the minimum wage amended the FLSA to permit employers to pay teenagers \$4.25 per hour for the first 90 days, and the current bill would not change this provision. The labor market experiences on which the estimates reported above are based did not reflect such a differential. Presumably, the differential could result in fewer employment losses for teenagers, more losses for adults, and fewer losses overall. While recent data indicate that few employers are using this option, its availability could cushion employment losses if labor markets weakened.

## **PREVIOUS CBO ESTIMATE**

On June 8, 1999, CBO issued an estimate of S. 192, which would increase the minimum wage to \$5.65 per hour in September 1999 and to \$6.15 per hour in September 2000. The current estimate of the direct cost to the private sector is based on the same methodology used for that estimate.

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3. See, for example, Alison J. Wellington, "Effects of the Minimum Wage on the Employment Status of Youths: An Update," *Journal of Human Resources*, Vol. XXVI, No. 1 (Winter 1991), pp. 27-46, Charles Brown, "Minimum Wage Laws: Are They Overrated?" *Journal of Economic Perspectives*, Vol. 2, No. 3 (Summer 1988), pp. 133-145, David Card and Alan B. Krueger, *Myth and Measurement: The New Economics of the Minimum Wage* (Princeton University Press, 1995), and Marvin H. Kosters, editor, *The Effects of the Minimum Wage on Employment* (AEI Press, 1996).

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